

No. SC92446

IN THE MISSOURI SUPREME COURT

BASF CORPORATION, INC.,

Appellant,

v.

DIRECTOR OF REVENUE,

Respondent.

BRIEF OF RESPONDENT DIRECTOR OF REVENUE

CHRIS KOSTER
Attorney General

JEREMIAH J. MORGAN
Deputy Solicitor General
P.O. Box 899

Jefferson City, Missouri 65102
(573) 751-1800

(573) 751-0774 (facsimile)

Jeremiah.Morgan@ago.mo.gov

GARY L. GARDNER

Assistant Attorney General
Post Office Box 899

Jefferson City, Missouri 65102
(573) 751-3321

(573) 751-9456 (facsimile)

gary.gardner@ago.mo.gov

ATTORNEYS FOR RESPONDENT
DIRECTOR OF REVENUE

TABLE OF CONTENTS

STATEMENT OF FACTS

Chemicals	5
Coal and natural gas	6
Electricity	6

ARGUMENT

I.	The Hannibal Plant does not convert recovered materials because 1) the plant uses liquids during manufacturing, and 2) in any event, the liquids used are not waste and are not converted. The liquids were never discarded materials, and they are removed from the final product and reused. (Responds to BASF's Argument A)	8
II.	The commission's decision and this Court's affirmance is a reasonable application of law to a previously unaddressed area, even if recovered materials include liquids. (Responds to BASF's Argument E)	13
III.	Purchases of chemical solvents are subject to tax because BASF failed to prove that solvents are required for 1) the operation of material recovery machinery and equipment and 2) solely for the operation of that machinery and equipment. (Responds to BASF's Argument B)	15

IV. Purchases of coal and natural gas are subject to tax because BASF failed to prove that coal and natural gas are required solely for the operation of material recovery machinery and equipment. (Responds to BASF's Argument D).....	18
V. Purchases of electricity are subject to tax because BASF failed to prove that the raw materials used in processing contain at least 25% of recovered materials. (Responds to BASF's Argument C).....	19
CONCLUSION.....	20
CERTIFICATES OF SERVICE AND COMPLIANCE	21

TABLE OF AUTHORITIES

Cases

<i>Branson Properties USA, L.P. v. Director of Revenue</i> , 110 S.W.3d 824 (Mo. banc 2003)	8, 16, 19, 20
<i>Lane v. Lensmeyer</i> , 158 S.W.3d 218 (Mo. banc 2005)	9
<i>Mackey v. Director of Revenue</i> , 200 S.W.3d 521 (Mo. banc 2006)	11
<i>Sneary v. Dirctor of Revenue</i> , 865 S.W.2d 342 (Mo. banc 1993)	14

Statutes, Rules and Other Authorities

RSMo § 143.093 2000	14
RSMo § 144.030 Cum. Supp. 2004	9, 10, 12, 13, 16, 19, 20
RSMo § 260.200 Cum. Supp. 2004	10, 11, 12, 13
RSMo § 260.360 Cum. Supp. 2011	13
12 CSR § 10–111.060	12
40 CFR § 261.33	13
2005 Mo. Laws 1079	9, 15
Letter Ruling 2207	12
Letter Ruling L8886	12
<i>Webster’s Third New Int’l Dictionary</i> , 658, 2171, 2258 (1993)	5, 6, 9

STATEMENT OF FACTS

The Director of Revenue adds the following facts.

Chemicals

The decision of the Administrative Hearing Commission refers to the chemicals for which BASF claims an exemption as “solvents” or “solvents at issue.” (A7)¹ Solvents are usually liquids present in a greater amount in a solution than the solute. *Webster’s Third New Int’l Dictionary*, 2171 (1993). They are used to dissolve solids into liquids so that the chemical reactions needed to manufacture herbicides and pesticides at the Hannibal Plant occur most thoroughly and efficiently. (A7) They are waste only in the sense that they do not become part of the final product. (A7, A8–A10, A13–A17, A20–21)

The chemicals at issue are removed from the manufacturing process and reused in the subsequent manufacture of herbicides and pesticides. (A10–A12, A17–A19, A21–A22) All but two of these chemicals are removed by distillation (A10–A12, A17–A19, A21, A34), which is driving off gas from a liquid by heating and then condensing the gas to a liquid. *Webster’s Third*, 658. One chemical is removed by caustic wash (A22, A34), which is cleansing

¹ Following BASF’s usage, L.F. refers to the Legal File and A refers to Appellant’s Appendix, which contains the decision of the commission.

or washing with a solution of caustic soda. *Webster's Third*, 356, 2578.

Sulfuric acid is removed through combustion, and then converted into a liquid. (A11, A34)

The chemicals at issue, according to the parties' stipulation, are used in the machinery and equipment at the Hannibal Plant not to enhance mechanical operation, but "solely to achieve the desired chemical reactions within that machinery and equipment." (L.F. 171, 175, 177, 182)

Coal and natural gas

Natural gas is burned in a furnace at the Hannibal Plant to remove sulfuric acid so that it may be reused and to incinerate liquid and gaseous waste. (A24) Coal is burned in boilers that generate steam to provide heat and pressure to the machinery and equipment, including chemical reactors and distillation columns, used in the manufacturing and removal process. (A25–A26)

Electricity

Electricity powers the pumps that move the component parts, ingredients, and chemicals through the manufacturing process, provide water for the manufacturing process, and propel unused chemicals into distillation columns in the removal process. (A27) Electricity also powers the motors that agitate ingredients in the chemical reactors, the electronic and computer

monitoring devices and heat control devices, and the heating, cooling, and lighting throughout the Hannibal Plant. (A27)

ARGUMENT

I. The Hannibal Plant does not convert recovered materials because 1) the plant uses liquids during manufacturing, and 2) in any event, the liquids used are not waste and are not converted. The liquids were never discarded materials, and they are removed from the final product and reused. (Responds to BASF's Argument A)

Tax exemptions are interpreted using the plain and ordinary meaning of words. *Branson Properties USA, L.P. v. Director of Revenue*, 110 S.W.3d 824, 826 (Mo. banc 2003). Furthermore, the taxpayer has the burden of proving entitlement to an exemption, and exemptions “are to be strictly construed against the taxpayer, and any doubt resolved in favor of application of the tax.” *Id.* at 825.

Although the General Assembly could have equated “recovered materials” and “solid waste stream” with potato soup, the legislature had something else in mind. Following BASF's analogy, “recovered materials” and a “solid waste stream” are just potatoes, not just soup or even potato soup. Because the Hannibal Plant uses just soup, it is not a material recovery processing plant and does not convert recovered materials.

Another way of putting it is that BASF argues that a “solid waste stream” does not mean a stream of solid waste, but a stream of any waste.

BASF's argument is contrary to common sense, because it ignores that the term "solid waste" modifies the word "stream." The General Assembly is not using "stream" in its sense of a "body of running water," but as a "constantly renewed supply." *Webster's Third*, 2258. The example *Webster's* gives is a steady stream of material flowed into the Smithsonian from all over the world. *Id.*

Moreover, BASF's argument is contrary to the canon of statutory construction that tax statutes should be construed in context with one another and with statutes involving similar or related subject matter. *Lane v. Lensmeyer*, 158 S.W.3d 218, 226 (Mo. banc 2005); A31. A material recovery processing plant "converts recovered materials into a new product, or a different form which is used in producing a new product[.]" RSMo § 144.030.2(4) Cum. Supp. 2004; A50–A51.² BASF agrees that "recovered materials" are defined as "those materials which have been diverted or removed from the solid waste stream for sale, use, reuse or recycling, whether

² After the periods at issue here, the legislature renumbered and amended the statute to require a facility to have as its "primary purpose the recovery of materials" and to exclude the "reuse of materials within a manufacturing process or the use of a previously recovered product." 2005 Mo. Laws 1079.

or not they require subsequent separation and processing[.]” RSMo § 260.200(28) Cum. Supp. 2004; A57.³

Focusing only on the word “stream” in the definition, however, BASF argues that liquids are included within a “solid waste stream.” This argument ignores the definition of “solid waste” in § 260.200(34) as “garbage, refuse and other discarded materials including, but not limited to, solid and semisolid waste materials resulting from industrial, commercial, agricultural, governmental and domestic activities[.]” (A58) As the Administrative Hearing Commission’s decision points out, “solid waste” must be “solid or semisolid,” and the chemicals that the Hannibal Plant uses are “primarily liquid in form, although the recovery process sometimes takes them temporarily into a gaseous state.” (A32) This is a reference to distillation used in the removal process, which ultimately results in a liquid. (A10–A12, A17–A19, A21, A34) The other two methods of removal also result in a liquid. (A11, A22, A34)

Moreover, the Hannibal Plant does not “convert recovered materials into a new product, or a different form which is used in producing a new product.” § 144.030.2(4); A51. There is no evidence that the chemical solvents are transformed into something else or that they change form to

³ The legislature has renumbered the definitions in this statute.

produce herbicides and pesticides. The plant removes the chemical solvents from the final product and reuses them. (A10–A12, A17–A19, A21, A22, A34) They do not become part of the final product. (A7, A8–A10, A13–A17, A20–A21)

Though what the legislature meant by a “material recovery processing plant” is a conclusion of law subject to de novo judicial review, the commission’s findings of fact that the Hannibal Plant uses primarily liquids and removes them from the final product and reuses them are reviewable for whether they are supported by substantial evidence. *Mackey v. Director of Revenue*, 200 S.W.3d 521, 523 (Mo. banc 2006). Even BASF recognizes that it uses primarily liquids, and it did not attempt to distinguish between liquids, solids, and gasses in its appeal of assessments and claims for refunds.

BASF says that there is nothing in the definition of “recovered materials” that means they must be solid. But it overlooks the words “solid waste” § 260.200(28) and A57), and in the definition of those words, the words “solid and semisolid waste” § 260.200(34) and A58). Exclusion of liquids from the material recovery exemption does not lead, as BASF argues, to the absurd result that no solid, liquid, or gas can be a recovered material. The definition of “solid waste” excludes “recovered materials,” but with respect to only materials recovered from “mining, milling, or smelting.” § 260.200(34);

A58. And gases may be recognized as a “material” with respect to only an exemption not at issue here. § 144.030.2(2); A50.

BASF says that the commission’s decision is contrary to the director’s letter rulings and Example B in the director’s regulation, 12 CSR § 10–111.060. Example B refers to a taxpayer who operates a “fuel recycling facility” as part of its cement manufacturing operation. The taxpayer “recycles fuel.” The taxpayer processes, transports, and recycles “solid and liquid *waste*,” “solid and liquid *wastes*,” and solid and liquid *waste* materials.” 12 CSR § 10–111.060(4)(B) (emphasis added); A63. Letter Ruling L8886 is the same fact situation as Example B (A65), and Letter Ruling 2207 involves solid waste (A67). These examples do not describe the operations of the Hannibal Plant.

The Hannibal Plant does not operate a recycling facility as part of its herbicide and pesticide manufacturing operation. The plant does not even recycle waste. Waste is “discarded materials.” § 260.200(34), A58. There is no evidence that the chemical solvents were discarded before they are used in manufacturing, and they are reused after manufacturing is complete. They are waste only in the sense that they do not become part of the final product. (A7, A8–A10, A13–A17, A20–A21) They are reused in the manufacturing process. (A12–A12, A17–A19, A21–A22)

So, even if the commission got it wrong, and soup were potatoes, and liquids solid, BASF still would be liable for tax because the solvents used to manufacture herbicides and pesticides are not waste. The solvents are not and never were “discarded materials.” § 260.200(34); A58. And even if the solvents were waste, the Hannibal Plant does not convert them into a new product or a different form that is used in making a new product.

§ 144.030.2(4); A51. The Hannibal Plant is not a material recovery processing plant, it does not convert recovered materials, and BASF does not qualify for the material recovery sales and use tax exemption.⁴

II. The commission’s decision and this Court’s affirmance is a reasonable application of law to a previously unaddressed area, even if recovered materials include liquids.

(Responds to BASF’s Argument E)

Decisions by courts or the commission that are determined by the court or the commission to be “unexpected” may be applied prospectively only,

⁴ Though the commission deemed this question moot (A34), the solvents are not even hazardous waste, which is excluded from “solid waste,” § 260.200(34). Because the Hannibal plant did not discard or intend to discard them, the solvents are only hazardous materials, 40 CFR § 261.33, and not “hazardous waste,” RSMo § 260.360(11) Cum. Supp. 2011.

“after the most recently ended tax period.” RSMo § 143.093 2000; A49. A decision is unexpected if it overrules a prior case or invalidates a previous statute, regulation, policy of the director, and the decision is not reasonably foreseeable. *Sneary v. Director of Revenue*, 865 S.W.2d 342, 348 (Mo. banc 1993). Significantly, the statute does not preclude “reasonable application of the law to areas not previously specifically addressed.” *Id.*

BASF argues that tax liability may not be imposed for expired tax periods because the commission’s decision invalidates the material recovery processing plant exemption and the director’s regulation. But the decision does not invalidate the material recovery exemption statute because it does not mean, as discussed above, that no sold, liquid, or gas may be a recovered material. And the decision does not invalidate the director’s regulation because, as discussed above, the example in the regulation does not apply to BASF’s situation.

Moreover, the decision does not overrule any prior decision of the commission, and if this Court were to affirm the decision, it would not overrule any prior decision of a court. The decision was foreseeable as a reasonable application of the law to an area not previously specifically addressed, whether recovered materials include liquids.

But even if recovered materials include liquids, as discussed above, the liquids the Hannibal Plant uses are not waste, and the plant does not convert

the liquids into a new product or a different form that is used in making a new product. Because these two reasons themselves do not invalidate any statute, regulation, or policy, or overrule any prior decision of the commission or court, and are reasonable applications of the law to an area not previously addressed, tax liability may be imposed for expired tax periods.

That the statute of limitations has expired for claims made under the earlier version of the material recovery statute, and that the legislature has narrowed the statute to likely assure that BASF and some other manufacturers will no longer even arguably qualify for the exemption⁵, are no reasons for prospective application of a decision unfavorable to the taxpayer. Assessments may be imposed and claims for refunds denied against BASF for expired tax periods.

III. Purchases of chemical solvents are subject to tax because BASF failed to prove that solvents are required for 1) the operation of material recovery machinery and equipment

⁵ To qualify for the exemption, a facility now must have as its “primary purpose the recovery of materials,” and the “reuse of materials within a manufacturing process or the use of a previously recovered product” is not enough. 2005 Mo. Laws 1079.

and 2) solely for the operation of that machinery and equipment. (Responds to BASF's Argument B)

The taxpayer has the burden of proving entitlement to an exemption, and exemptions “are to be strictly construed against the taxpayer, and any doubt resolved in favor of application of the tax *Branson Properties*, 110 S.W.3d at 825. BASF failed to carry its burden of proof. (A40)

For materials and supplies to qualify for the material recovery processing exemption, they must be:

- “required solely for
- the operation, installation or construction” of
- “machinery and equipment, purchased and used to establish new,
- or to replace existing,
- material recovery processing plants in this state.”

§ 144.030.4(3); A39. Assuming that the Hannibal Plant is a material recovery processing plant and the chemical solvents used there are supplies, BASF failed in its burden of proof (A40) to show that the solvents are required for the operation of material recovery machinery and equipment (A37–A38) and required solely for the operation of that machinery and equipment (A38–A40).

BASF argues that a stipulation, which the hearing commission considered to be a non-binding conclusion of law (A35), carries its burden of

proof and that the commission's conclusions are speculative. But BASF is mistaken, and the commission's conclusions are consistent with the stipulation as a matter of fact.

The parties did not stipulate that the chemicals enhance the operation of the material recovery machinery and equipment at the Hannibal Plant. Nor did they stipulate that the chemicals are required solely for the operation of that machinery and equipment. The parties stipulated that the chemicals at issue are used in the material recovery machinery and equipment at the plant "solely to achieve the desired chemical reactions within that machinery and equipment." (L.F. 171, 175, 177,182)

As the commission pointed out, the chemical reactors at the plant can operate without the solvents (A38) — they can provide heat, pressure, and agitation without the solvents (A37). Heat and pressure to the reactors are provided by the coal that is burned in boilers at the plant (A25–A6), and agitation is provided by the electricity that powers motors (A27). Solvents enhance the chemical reactions within the reactors that would occur without the solvents, but not as thoroughly and efficiently. (A7) And as the commission pointed out, BASF claimed exemption for all purchases of solvents (A3–A4), and there is no evidence that solvents are used *solely* for the operation of replacement, material recovery machinery and equipment that BASF had purchased (A39–A40).

IV. Purchases of coal and natural gas are subject to tax because BASF failed to prove that coal and natural gas are required solely for the operation of material recovery machinery and equipment. (Responds to BASF's Argument D)

As in the case of chemical solvents, assuming that the Hannibal Plant is a material recovery processing plant and the coal and natural gas used there are supplies, BASF failed in its burden of proof (A46) to show that coal and natural gas are required solely for the operation of material recovery machinery and equipment. (A45–46) BASF argues that the record does not show that the coal and natural gas burned at the plant is used for any purpose other than material recovery. But BASF sets the burden of proof on its head.

As the commission pointed out, BASF claimed exemption for all purchases of coal and natural gas (A4–A6), and not just those purchases required for operation of material recovery machinery and equipment (A45–A46). BASF did not show what pieces of machinery and equipment consuming coal or natural gas qualify for the exemption (that is, are material recovery machinery and equipment) or provide energy usage studies that show what portion of coal or natural gas was used for qualifying and for non–

qualifying machinery and equipment. (A46) BASF failed to carry its burden of proof. *Branson Properties*, 110 S.W.3d at 825; § 144.030.2(4).

V. Purchases of electricity are subject to tax because BASF failed to prove that the raw materials used in processing contain at least 25% of recovered materials. (Responds to BASF's Argument C)

For electrical energy to qualify for the material recovery processing exemption, it must be:

- used in a material recovery processing plant as defined by § 144.030.2(4), and
- the raw materials used in such processing contain at least 25% recovered materials as defined by § 260.200.

§ 144.030.2(12). Assuming that the Hannibal Plant is a material recovery processing plant, the commission concluded that nearly all of the chemicals BASF recovers are not recovered materials and that as to the remaining chemicals, BASF failed to meet the 25% test. (A47) Whether chemical solvents are recovered materials has been discussed above.

BASF argues that it did meet the 25% test. But the period for which BASF claims exemption for purchases of electricity do not coincide with BASF's declarations of recovered materials. BASF claims exemption for purchases of electricity from September 1, 2001, through December 31, 2003.

(A6) BASF's declarations of recovered sulfuric acid are for 2004, 2005, and 2006. (L.F. 192–195) And its declaration for other solvents is entirely silent as to the year. (L.F. 196) BASF failed to carry its burden of proof. *Branson Properties*, 110 S.W.3d at 825; § 144.030.2(12).

CONCLUSION

For the reasons stated above, the decision of the Administrative Hearing Commission should be affirmed.

Respectfully submitted,

CHRIS KOSTER
Attorney General

/s/ Gary L. Gardner
GARY L. GARDNER
Assistant Attorney General
Missouri Bar No. 24779
Post Office Box 899
Jefferson City, Missouri 65102
573-751-3321
573-751-9456 (facsimile)
gary.gardner@ago.mo.gov

JEREMIAH J. MORGAN
Deputy Solicitor General
Missouri Bar No. 50387
P.O. Box 899
Jefferson City, Missouri 65102
(573) 751-1800
(573) 751-0774 (facsimile)
Jeremiah.Morgan@ago.mo.gov

ATTORNEYS FOR RESPONDENT
DIRECTOR OF REVENUE

CERTIFICATES OF SERVICE AND COMPLIANCE

I hereby certify that a true and correct copy of Brief of Respondent Director of Revenue was filed electronically and served via Missouri CaseNet this 28th day of September, 2012, upon William B. Prugh, Christopher S. Abrams, Mark A. Olthoff, Jon R. Dedon, and Jeremiah J. Morgan.

I hereby certify that I signed the original of this brief and that it contains the information required by Rule 55.03, complies with the limitations contained in Rule 84.06 (b), and contains 3,407 words exclusive of cover, signature block, and certificates.

/s/ Gary L. Gardner